HB
177
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bp

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April 30, 2007

The Honorable Carl Gatto, Co-Chair
House Resources Committee
State Capitol, MS 3100
Juneau, AK 99801

Representative Gatto:

Thank you for the opportunity to provide testimony to the House Resources Committee. Enclosed for your reference is my written response to the various questions raised by the committee which I was not able to fully answer during the course of testimony. Also enclosed is a copy of the public testimony BP provided on HB177.

Thank you again for the opportunity to participate in your deliberations.

Sincerely,

David Van Tuyl

David Van Tuyl
Gas Commercialization Manager, BP Alaska

Attachments (2)
cc: Committee Members

Questions Raised by House Resources Committee
Following Testimony Provided by David Van Tuyl on April 13, 2007

1. **What is the longest duration of firm transportation commitment currently held by BP? What is the shortest?**

   The longest term of firm transportation (FT) commitment that BP has entered into is 20 years. This 20 year term was with Midwestern Gas Transmission Company on a gas pipeline project in Tennessee (Nov. 2006).

   BP also enters into numerous short duration FT commitments. While monthly FT commitments by BP are more typical for these short duration contracts, the shortest term of FT commitment is daily. BP takes on numerous daily, weekly or monthly short term FT contracts.

2. **How many open seasons has BP participated in?**

   We do not track open seasons in which BP has participated, but BP has a history of participating in basin opening, system debottlenecking and market development pipeline projects through the open season process. A few recent examples of successful pipeline projects which BP has supported through shipping commitments include:

   - Cheyenne Plains – 40,000 Dth/d for 10 years starting in 2005 (basin opening)
   - Centerpoint – 100,000 Dth/d for 5 years starting in 2007 (basin opening)
   - Vector – 50,000 Dth/d for 10 years starting in 2007 (market expansion)
   - Rockies Express – 100,000 Dth/d for 11.5 years starting in Jan 2008 (basin opening)

     (where Dth = "decatherm", or 1,000,000 Btus)

3. **Can you cite an example in which competing pipeline proposals were submitted to FERC and advanced to the marketplace?**

   Yes. In 1999, both Gulfstream Natural Gas System, LLC and Buccaneer Gas Pipeline Company, LLC announced competing projects for a pipeline across the Gulf of Mexico from the Mobile Bay area, Alabama, to the growing market of central Florida. Gulfstream conducted an open season for its proposal in March 1999.

Because Buccaneer was proposed to be constructed under the FERC's then-existing optional certificate regulations,[1] it was not required to conduct an open season but approached shippers individually. In April 2000, both projects received Preliminary Determinations from the FERC allowing them to continue to compete in the market. [*Gulfstream Natural Gas System, LLC,* 91 FERC ¶61,119 (2000); *Buccaneer Gas Pipeline Company, LLC,* 91 FERC ¶61,117 (2000).]

Neither Gulfstream's initial open season nor Buccaneer's initial efforts resulted in contracts for all of the capacity on the respective systems. As a result of continued competition between the two projects after receipt of the Preliminary Determinations, by late 2000 Gulfstream had secured a solid customer base and received approval for their proposed landfall location in central Florida. As a result, Gulfstream gained the advantage in the marketplace over Buccaneer and the two projects ultimately were merged together in early 2001.

Other examples are identified in various Energy Information Agency (EIA) reports. In an appendix to its 1998 report on Deliverability on the Interstate Natural Gas Pipeline System, the EIA included a discussion of Natural Gas Pipeline and System Expansions, 1997-2000. One of the areas discussed was the effort then being made to move increased volumes of gas from the Western Canada Sedimentary Basin into the Midwest U.S. market. There, EIA explained as follows:

> *These efforts include several very large projects. For example, a new natural gas pipeline (the Alliance project) would bring gas from British Columbia to the Chicago, Illinois, area along the right-of-way of an existing oil pipeline. Several other projects are competing with the Alliance project, including the Viking Voyageur Pipeline, which is a 1.4 Bcf/d line between the Noyes, Minnesota, import point and the Chicago, Illinois, area, and the Northern Border Project 2000, which is a 400 MMcf/d expansion that includes a proposal to extend the system to Indiana and possibly to the Michigan-Canada border to serve the Ontario marketplace.*

The Alliance project was filed with FERC in 1996 and the Viking Voyageur project was filed with the FERC in 1997. After competing in the marketplace for commitments, the Alliance project became fully subscribed and was completed. The application for the Viking Voyageur project was withdrawn from FERC in 1998.

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[1] Because the Buccaneer project was announced prior to the issuance of a change in FERC policy terminating the optional certificate regulations, the project was permitted to proceed using the optional certificate approach.

In a 2004 report on U.S. Natural Gas Pipeline and Underground Storage Expansions in 2003, the EIA discussed efforts to bring additional supplies of gas to the Southeast United States, including competing projects to build pipelines to bring LNG being imported into the nearby Bahamas into the south Florida market. The EIA reported as follows:

> *Looking to the future, 19 pipeline expansion projects have been proposed that could tentatively add as much as 11,840 MMcf/d to gas pipeline capacity between 2004 and 2008. However, a large portion of this potential capacity represents volumes from competing proposals for several large new pipelines and several major expansion projects that remain in the planning stage.*
>
> *Several proposals, such as the AES Ocean Express Pipeline, the Tractebel Calypso Pipeline LLC, and the El Paso Seafarer Pipeline projects, represent separate 750-850 MMcf/d capacity pipelines that would extend between LNG vaporization facilities located in the Bahama Islands and south Florida. The likelihood that all three projects will be built is marginal. All are competing for similar markets and predicated upon the future development of new gas-fired power plants in south Florida. While the first two pipelines have been tentatively approved by FERC, the Seafarer pipeline application was not submitted to FERC until April 2004.*

Both the AES and Tractebel projects received a Preliminary Determination from FERC in 2003. As reported by the Oil & Gas Journal, after competing in the marketplace for commitments in late 2004 the three LNG projects were merged together into a single project. As of this date, the combined project continues to await approval for the construction of the revaporization terminal in the Bahamas.

BP Testimony on AGIA (HB177)
House Resources Committee
April 13, 2007

- Mr. Chairman, members of the committee, for the record my name is Dave Van Tuyl. I am the Gas Commercialization Manager for BP Alaska. Thank you for the opportunity to testify before you this afternoon.

- My testimony will start with some general comments about the importance gas pipeline project, then I'll provide some specific suggestions on the AGIA bill, then I'll turn to a brief discussion of financing and risk, and then I'll conclude with a summary.

BP's Vision for Alaska

- I'd like to spend a moment to look into the future and consider the opportunities we have before us.

- BP has a **long history in Alaska**. BP has been actively involved in the exploration, development and production of Alaska's North Slope energy resources for decades.

- And we see the opportunity for a bright future ahead. In fact, we envision our **50-year future in Alaska**. It's not just a slogan.

- So how might that vision look to our company?

- I'd like to turn your attention to the graph at the bottom of slide 2, which shows the **possibility of the future that BP sees** in Alaska, depicting BP's share of production through time.

- There are a few key points to draw from the graph.

- The days of **high plateau** production are behind us.

- We still have a significant level of production today, but that **production will continue to decline** with time. That's what the dotted red line depicts.

- That shows production declining at historic levels, which already would require **significant investment**.

- We can make up that decline in production with new investment that would result in new production from **heavy oil resources and from gas**.

- But it's not a given It's a view of what's **POSSIBLE**.

- That future is only made possible with an Alaska gas pipeline project.

BP Key Messages

- So **BP wants and needs a gas pipeline.** And we need that pipeline to be built for a low capital cost and then operated cost efficiently. We believe that is what is required to make the project happen and be successful. Low costs are good for both BP and the State because it results in lower tariffs, higher netbacks and more revenues for the State and BP.

- Also, a low cost project will provide incentive to explore for more gas to keep the pipeline full into the future. That is also good for the State and for BP.

- The best way to ensure there is gas exploration in the future is to get a gas pipeline built in the first place, and to get it built for a low cost.

- This is a **hugely important project to BP, to Alaska and to the nation.** It represents the largest, known, undeveloped gas resource in the United States, and in BP's global portfolio. The gas project is important in its own right – but it also extends the economic life of Alaska's oil production for decades. Extending oil production is good for the State, the nation and for BP.

- We **share the governor's and the legislature's desire** to get a successful gas project moving, and **BP stands ready** to engage with the administration and legislature to reach a balanced fiscal framework that works for all the parties.

- And finally, a successful framework will set the foundation for **a stable, healthy, and viable oil and gas business for decades** to come. BP's future in Alaska is directly linked to the gas pipeline project.

- That's why we are very encouraged by the Governor's and the legislature's enthusiasm about getting Alaska's gas to market. That is also our vision, and so we share your enthusiasm. It's the key to Alaska's future, and to BP's future in Alaska.

- Therefore, it's important that we get it right.

- BP sees AGIA as the Administration's expression of its commitment to advance the gas pipeline project in an open and transparent way. We applaud that good faith expression.

- Developing the right process is difficult. Since first seeing AGIA at its roll out to the legislature and the public on March 2nd, we have identified a number of important areas of concern for you to consider.

- We believe AGIA CAN be successful if some key issues are addressed, and I've summarized those concerns here, and will discuss them in more detail shortly.

- We believe AGIA may create some unintended consequences that could jeopardize the vision of getting Alaska's gas to market quickly, and at low cost. We believe it is important for the Legislature to consider these areas of concern as you deliberate on AGIA.

- Why do we feel these changes are so important? It's because we want the project to be a success, because there is much at stake for BP and for Alaskans.

What A Successful Gasline Means

- It's worth a brief reminder of the importance of a successful project. And I'd like to emphasize that what we need is a SUCCESSFUL gas pipeline, not just ANY gasline.

- As we've said, this is a project of tremendous scope and scale and that's what the picture reminds us of. Because of this it presents tremendous risk. But if it's done right, it also presents the opportunity for great benefits as well.

- Because there is much at stake, we need to get it right.

- The project creates the opportunity for jobs for Alaskans, and if we deliver a successful, low cost project, for revenues to the State and to BP well into the future.

- We can create a whole new industry of gas exploration with a successful, low cost project. Gas exploration and expansion are only possible if the pipeline gets built in the first place, and if it's built for a low capital and operating cost. That will make it attractive for bringing new volumes into the project, which benefits the State, gas explorers, and initial shippers as well.

- A successful gas pipeline project will provide the opportunity to bring a long term gas supply source for use by Alaskans.

- And fina"y, gas sales will diversify Alaska's economy for decades into the future.

- As I said, there's a lot at stake, so we need to get it right.

- Now I'll turn specifically to our suggestions on AGIA that would help AGIA deliver a success gas pipeline.

- Each of the next three slides starts out with the statement, "AGIA can help deliver a successful gas pipeline if...", and I'll describe modifications we recommend to AGIA on each slide.

Use Objectives Instead of Prescriptive Requirements

- First, AGIA can help deliver a successful gas pipeline if we use objectives, instead of prescriptive requirements

- We fully support the State clearly providing its objectives for a successful gas pipeline project

- The concern we have is that AGIA as drafted presupposes solutions to those objectives, such as those contained in Section .130 starting on page 3 of the bill.

- We think that prescribing solutions up front will not result in the best project. We've heard the administration state their intent that "we need to let industry do what they do best". We fully agree with that intent, and think it only gets met if industry is allowed to offer its own unique, creative solutions.

- One specific example of prescribing a solution we find particularly troubling is the issue of toll subsidization.

- AGIA as drafted can result in one party subsidizing another. Now I'm referring to the language in Section .130(7) of the bill on page 6-7. AGIA specifically requires initial shippers - who financially underpin the project and who already bear most of the risk associated with the project - to bear yet another risk and additional cost: the risk of tariff increases of 15% or more **by subsidizing expansion shippers**
    - First I want to make clear that the issue is not just the potential for a 15% rise in the tariff. And by the way, the "15% cap" as I've heard this language characterized is not 15%, and it's not a cap. In reality it could result in a significantly higher increase than 15%.
    - But the more fundamental issue is that we believe the issue of subsidization is contrary to FERC policy.
    - We understand and we fully share the State's desire for a pipeline to be expandable - it's absolutely good business.
    - However, we believe that the **State should carefully consider** the potential adverse consequences of requiring pipeline owners to increase rates on their initial customers to subsidize expansion shippers.
    - A policy of subsidization places additional risk on the initial shippers, making the project less attractive, and therefore puts the project at risk.

- Now if the **<u>State</u> wants to subsidize others,** it can certainly do so itself, directly, as a policy choice. But we don't believe it's good policy to do so with other peoples' money.
- Congress made clear in the Alaska Natural Gas Pipeline Act of 2004 that rates for initial shippers should NOT increase if a mandatory expansion was ordered. In fact, the language of the Federal Law states that

  "the [FERC] shall...ensure that the rates do not require existing shippers on the Alaska natural gas transportation project to subsidize expansion shippers." - ANGPA, Sect. 105(b)

- Also, in Order 2005, FERC put in place a rebuttable presumption of rolled in rates for expansions provided it did not require subsidization by initial shippers [and I'd like to read paragraph 125 of the Preamble]:

  "In conclusion, to provide guidance to potential shippers in advance of the initial open season that is the subject of this rule, the Commission intends to harmonize both objectives (rate predictability for initial shippers and reduction of barriers to future exploration and production) in designing rates for future expansions of any Alaska natural gas transportation project. It is consistent with our guiding principle that competition favors all of the Commission's customers, as well as with the objectives of the Act, to adopt rolled-in rate treatment up to the point that would cause there to be a subsidy of expansion shippers by initial shippers, if any subsidy were to be found." [Order 2005, paragraph 125]

- These two excerpts from Federal law and regulation, suggest that .130(7) of AGIA and Federal law could be in conflict. This conflict issue actually becomes quite complicated, and we are continuing to study it. If indeed there is a conflict, resolving it would add delay and uncertainty. We do not see how that is in any of our interests.

- So we remain concerned about this conflict.

- In any case, we believe that this type of provision, requiring a subsidy for not-yet-ready shippers at the expense of initial shippers, would be a disincentive for potential shippers participating in an open season. That's not in any of our interest.

Avoid Exclusivity to Ensure a Pipeline Gets Built

- The second modification that would enable AGIA to help deliver a successful gas pipeline relates to the issue of exclusivity.

- Under Sections .260 and .440 of the bill on pages 18 and 23, AGIA would result in an **exclusive winner** before any real work is done and awards State funds based on promises, not results

- We are concerned that this feature may actually PRECLUDE a successful project from moving forward. That's clearly not anyone's intent, but could be an unfortunate unintended consequence.
  - Our understanding of AGIA is that expedited regulatory handling is offered only to the licensed project, and that the State can be penalized for assisting another competing project
  - We're concerned that this approach may actually conflict with Federal law and regulation, which favor competition among various project proposals and market involvement in the choice.
  - We think it wise that the State consider **avoiding any notion of exclusivity** or the government 'picking a winner'; I'm not aware of any example where that has worked successfully.

- We recognize that the Administration has, in good faith, laid out selection criteria under Section .170 to enable the selection of the exclusive winner in as transparent a way as possible.
- So that leaves a fundamental question: Should the State pick an exclusive "winner" based only on a proposal?
- That approach gives us concern.
- We believe that the **State can help to advance the project by setting out a clear framework for investors** - from there the market will work to identify the most effective project
- And we support open competition in the **marketplace**, rather than in advance of actual performance or before the competition actually starts
- In fact, the FERC requires that the **market demonstrate that it wants that application** before awarding a certificate to an applicant. That's what happens in a successful open season.
- We believe the Federal law under ANGPA offers a good model, in which expedited regulatory handling is provided to ANY project.
- We certainly understand that from the State's perspective, there are a number of **specific things desired from ANY project** (jobs and training for Alaskans, gas access for Alaskans, pipeline expansions).
- We support all of these objectives.
- These objectives can and will be addressed by a successful project through open competition in the marketplace.

- A third area we suggest be considered carefully is that, although AGIA seeks to get a project moving, and we fully support that objective, **it does not sufficiently address the resource framework, which is the key enabler for a financeable project**
  - That said, **we are encouraged that AGIA recognizes at least in part**, the importance of some of these key resource issues.
  - In Section .310 on page 19, AGIA seeks to address the issue of **royalty valuation**, which has been an historic source of conflict

between industry and the State. But we are concerned that these terms **do not provide sufficient clarity** to justify making the firm transportation commitments required to underpin the project.

- The royalty valuation provisions depend on future regulations; neither the shippers nor the legislature know what those regulations might say.
- The valuation regulations would allow for retroactive adjustments, and the regulations associated with RIV/RIK switching imply that "reasonable" disproportionate costs and "reasonable" interference with marketing is okay. I don't know what that means or how to evaluate that.
- Also, these regulations may change every two years.

- In Section .310(b)(3) on page 19 of the bill, AGIA seeks to address royalty issues associated with **RIV/RIK switching** which is incompatible with the long-term arrangements required to make a gas pipeline project happen (RIV = "royalty in value"; RIK = "royalty in kind"). RIV/RIK switching is problematic for at least two reasons:
  1) One is that if the State chooses to switch let's say from in-value to in-kind, the **shipper would have to come up with additional gas to satisfy its customers** in the marketplace.
  2) The second problem is associated with obtaining the capacity on the pipeline if the State switches. For instance, if the State had originally elected to take gas in value, the shipper would have obtained the associated capacity to ship the State's associated share of gas. If the State then switched from in-value to in-kind, this could result in **stranding downstream capacity**, raising the question of who would pay for that cost of unused capacity.
- Under AGIA, the specific solution to RIV/RIK switching is **left to future regulation** that, as I mentioned earlier, would allow for the lessee to bear disproportionate costs, and potentially interfere with long-term marketing.

- AGIA includes a provision related to gas production tax in Section .320 on page 21. However, the gas production tax rate is not established, and **only becomes known after the conclusion of the open season**. A shipper would not know what the production tax is before having to make the FT commitment, which would be an incredible risk.
- The gas production tax rate is then only established for a period of 10 years, which for reference is a **fraction of the period that shippers will likely be required to make their firm transportation commitments**.
- **AGIA is silent as to the many other payments** made to the State, which constitute the majority of industry payments.

- It is widely understood that the resource owners will pay the cost and bear the risk in building a pipeline **whether they own it or not**

- Resource owners will pay all the costs of the pipeline, either directly or indirectly by reimbursing the pipeline owner through the tariff for the costs they incur

- It's the RESOURCE that drives the construction of a basin-opening pipeline like this project, NOT the PIPELINE that drives the resource!

- Therefore, solving the resource issues with clarity is key to allowing a project to move forward.
  - Multi-billion dollar commitments spanning decades are needed to financially underpin this project;
  - Just like Wall Street needs to know the rules before lending money, resource owners need to know the fiscal rules that will govern the project before making commitments that will enable the pipeline to be financed.

- Although this is widely known, the details of an upstream framework are complex and will take time and effort by both the State and the producers to agree - but unless they are addressed, a project won't secure financing; it won't advance
  - The provisions of Sections .310 and .320 do not adequately address these upstream issues. To do so requires robust interaction.

- Thus far, there have been some high lievel discussions between our senior management and the Governor.

- But we've been disappointed in the level of interaction with the Commissioners and their staff. That's where the problem will ultimately be solved.

- Over the last three weeks we've had three constructive discussions with one deputy Commissioner. That's a start.

- We would welcome the opportunity to increase the frequency and depth of dialogue with the Administration.
  - BP remains ready to engage at any time

What Is So Important About FT?

- We've heard a fair amount, in this committee and others, about this term called "FT" which is short for firm transportation commitments
  - In listening to many of these hearings it seems to me that the nature of these commitments is not fully understood
  - However, these commitments are absolutely critical for a gas pipeline to be successful
  - Therefore, I thought I'd spend a moment hopefully adding a bit of clarity to the understanding of FT

- These commitments, typically obligations to "ship or pay" made by the resource owners or "shippers", are needed by the pipeline company to get financing
    - validating just how important they are, we've heard some very simple and straightforward comments from pipeline companies who have testified in the past couple of weeks
    - TransCanada has said "No customers, no credit, no pipeline" (and in this context customers means shippers)
    - Enbridge put it even more simply by saying "No producers, no pipeline"

- Those aren't "political" statements. They are statements about the simple financial truths of gas pipeline projects

- FT is a binding FINANCIAL obligation. I've sometimes heard FT described as "committing gas to a pipeline". I've heard that quote from industry as well as others, so I'm not pointing any fingers here. But I just wanted to make it clear that FT is an actual financial obligation
    - Typically, FT is known as a "ship or pay" obligation
    - That means that a shipper commits to pay the pipeline company for use of its service whether or not the shipper actually delivers gas to the line
    - And it's also important to note that a company does not need to have ANY gas resources to enter into a firm transportation commitment. Any company who meets the creditworthiness standards set by the pipeline company is free to bid for capacity. Gas pipelines are "open access". Anyone is free to obtain capacity if they make the requisite commitments.
    - These FT commitments are real financial obligations. We are required to disclose these commitments as additional information with our filing with the SEC.

- Clearly, an FT of this magnitude will be taken into consideration by financial entities like banks when evaluating our company. That's because it's a real obligation.
- Once these commitments are made to the pipeline, they are used by the pipeline to obtain financing from the financial markets, provide coverage for that financing, and a return for the pipeline.
- Maybe an example to explain the nature of these commitments would help. Let's say we've had a successful open season, the pipeline gets project financed, is built and it's in operation. Then, heaven forbid, for some reason the pipeline company goes bankrupt. Not what we're hoping for, for sure. But what would the lenders do? So they would turn to the FT commitments made by the shippers to get their repayment. And these FT commitments would indeed be paid to the lenders. That's because they are a REAL FINANCIAL COMMITMENT. They have to be properly taken into consideration when evaluating project economics.

- The scale of these commitments is often oversimplified. It's not "just" the capital cost of the project, if that weren't in itself a large enough commitment.
  - the commitment is for what is known as the "demand charge" which is the cost of service the pipeline will charge through time
  - Capital is one major component
  - But for illustration, I've provided some broad assumptions to put the scale of these commitments in perspective.
    - assuming a 4.5 bcfd project, at a unit cost of $3.50/mcf for 25 years results in a total FT commitment of $144 billion
    - That's a huge sum, even for a company the size of BP

- These long term commitments are just that – commitments. Therefore, they represent real risk. And the size of these commitments magnifies the risk. And that risk is borne by those making the commitments,

Risk Diagram

- This next slide attempts to show how **risk is ultimately allocated** in a major resource development project like the Alaska Gas Pipeline Project

- I'm going to **step through it one bit at a time.**

- First, we start with the **Resource Owners** – that's of course the State of Alaska, and it includes the lessees, like BP, CP, EM, Chevron and others.

- There are certain risks that are inherent to the resource itself.
  - There is always price risk associated with selling a commodity like gas
    - that's the risk that the price of gas will fall in the future, possibly below the tariff
  - There's also production risk
    - Keeping the pipeline full for project life
    - Being able to deliver the full volume every day
    - These risks are important considerations when a resource owner has to make the firm transportation commitments necessary to underpin the project

- Next, there's fiscal risk for a lessee; that's the risk that the fiscal terms on the upstream business might change. On major infrastructure projects like this around the world, it's not uncommon for host governments to address fiscal risk with a mutually agreed framework.

- There are also a whole host of risks associated with constructing the pipeline itself
  - Regulatory process could change ➔ schedule risk
  - Material, labor and equipment costs ➔ cost risk, which includes project management and execution
  - Need for finances from the capital markets ➔ finance risk

- **What is critical to appreciate** is that all these project-related risks that are taken by the pipeline company are ultimately passed through to the resource owners through the toll
    - The Pipeline company receives a regulated rate of return
    - Gets a reasonable return on investment commensurate with the risks
    - That's the pipeline's reward
    - In exchange for this regulated rate of return, the regulators ensure that the pipeline does not take on certain risks
    - These instead are passed through to the resource owners, provided that the pipeline owner delivers the project on time and operated efficiently
    - That's how the risk / reward balance is struck by the pipeline regulators

- So ultimately, **ALL RISKS** are either borne directly by the resource owners, or are passed through to the resource owners through the toll

- To ensure a low cost project, it's important that those that are bearing a risk are able to manage that risk
    - They are commercially motivated to manage that risk downwards

- To reiterate, it's critical that the fiscal system is established in such a way that the risks associated with the resource or "upstream" are adequately addressed to ensure the risk / reward balance is right.
    - That will maximize the likelihood of having a successful open season and a successful project.
    - The State is uniquely positioned to address this risk

Summary

- So in summary, I'd like to leave you with four messages.

- First, BP wants and needs a gas pipeline. It's critical to our vision of the 50-year future in Alaska.

- Second, BP fully supports an **open process** that leads to a mutually agreed fiscal framework with the State that **allows a project to advance and attract financing**

- We think there should be an **open and transparent public review** of the resulting framework
  - The Governor has already committed to keep the legislature and the public apprised - we fully support her in that.
  - It is critical that the legislature supports and endorses that framework
  - The judicial branch should review that framework to ensure constitutionality
  - The people of Alaska and all 3 branches of government should and will be consulted.

- We think that the resulting framework should be **available to all investors** to ensure competition

- Third, we believe that a number of midstream details in AGIA should be fixed.
  - o We think the best project will come about if the State allows industry to offer solutions, rather than prescribing them up front.
  - o The provisions which result in rate subsidies of one party to another should be eliminated
  - o **any notion of exclusivity** or the government 'picking a winner' like those contained in Sections .260 and .440 should be avoided
  - o Any process should allow competition in the marketplace to work

  - It is easy to make hopeful promises but it is harder, and vitally important, to deliver performance
  - That is what we believe the State should require. **Delivery, not promises.**

- And finally, a **mutually agreeing an upstream framework is critical.**

- The resource issues must be resolved for the project to proceed and to ensure the resource owners have sufficient confidence to make the necessary long term financial commitments in an open season required to advance the project. Section .310 and .320 of AGIA do not accomplish this objective.

- We are ready to engage on developing that upstream framework.

- Thank you for the opportunity to testify today. I'd be happy to answer any questions you might have.

Alaska Natural Gas Pipeline Project

Testimony on AGIA

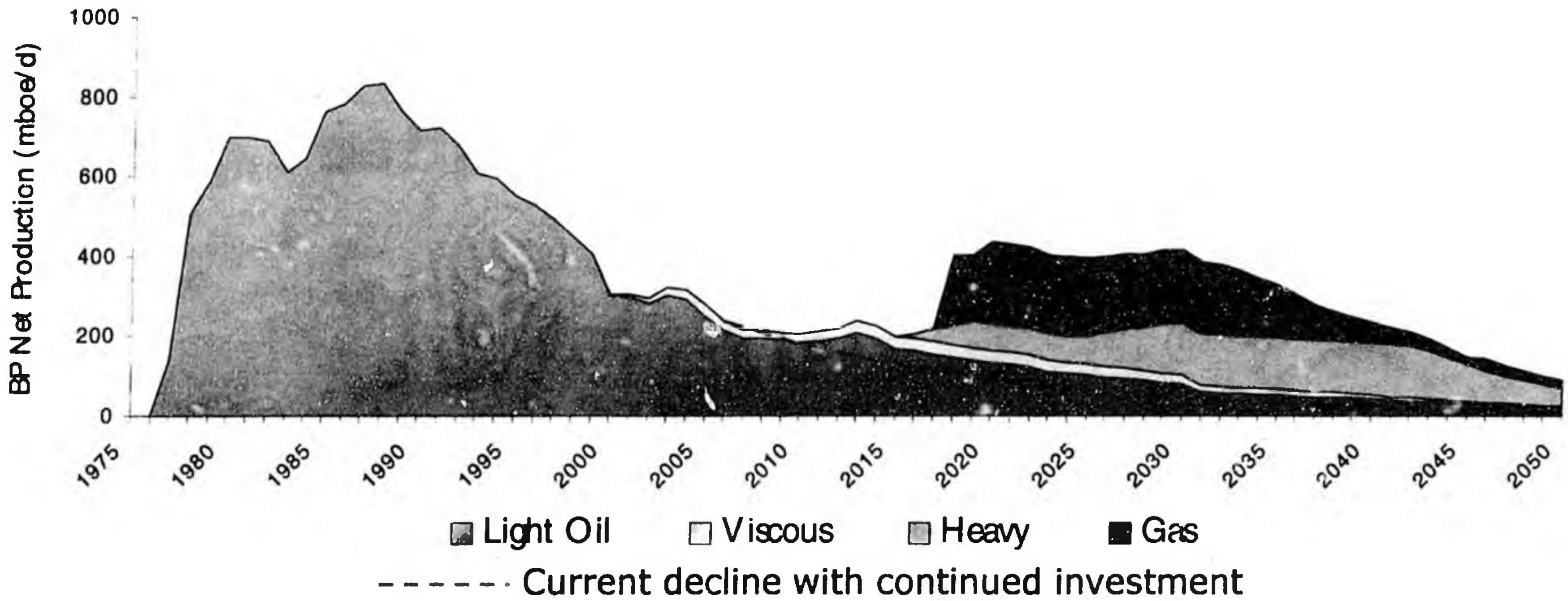
House Resources Committee

April 13, 2007

bp

BP's Vision for Alaska

- BP has a long history in Alaska....
- .....and we look forward to a 50-year future
- That future is only possible with a gas pipeline



BP Key Messages

- BP wants and needs a successful gas pipeline

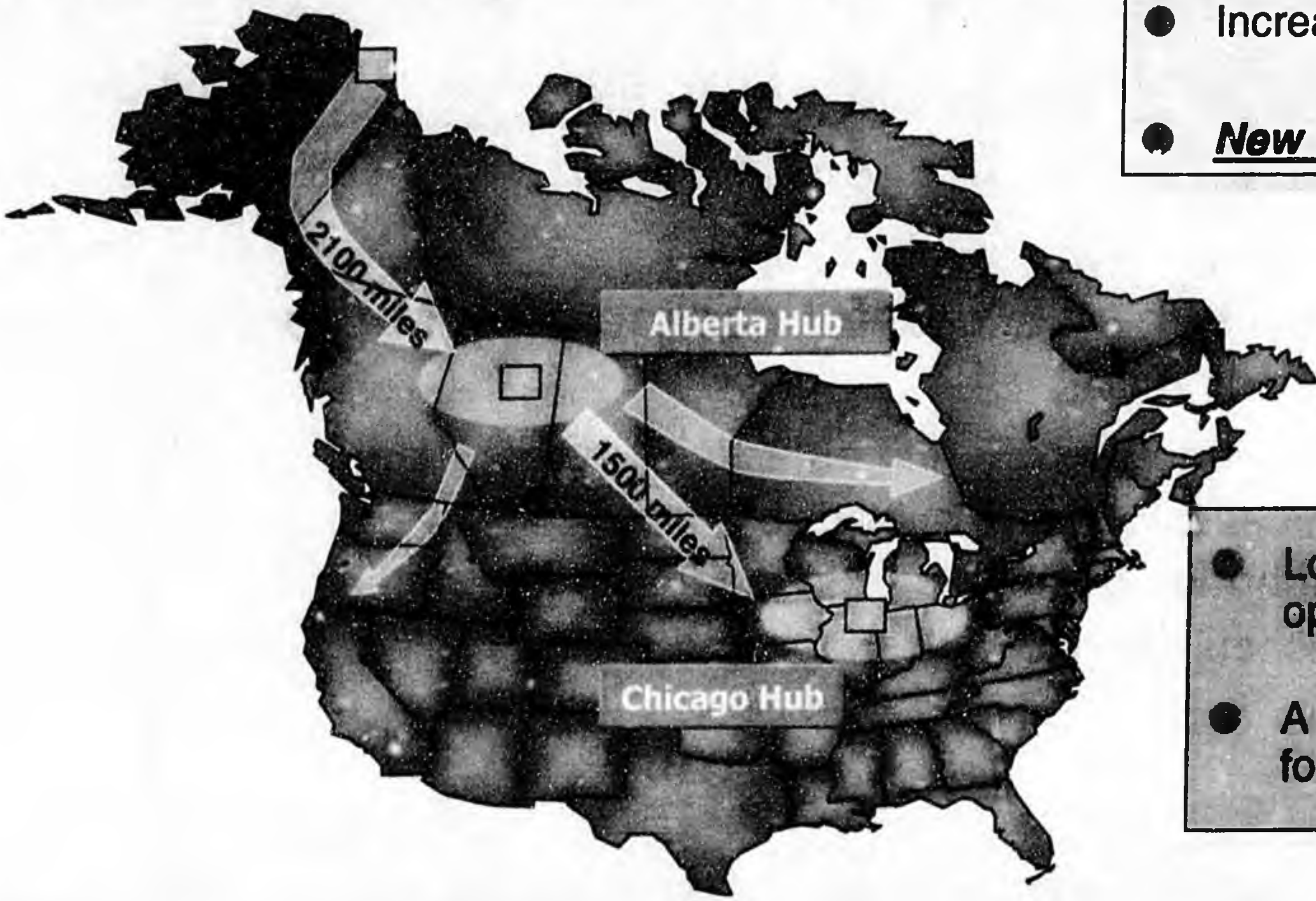
- BP supports Gov. Palin's desire to get Alaska's gas to market

- AGIA can help deliver a successful gasline project provided key issues are addressed
  - Encourage best solution by offering objectives, rather than requirements
  - Don't require initial shippers to subsidize others
  - Encourage competition by allowing the market to determine the "winner"
  - Resource rules should be clearly defined and not be subject to change

What A Successful Gasline Means

- ***Jobs*** for Alaskans
- Additional ***revenue*** for future generations

- Increased ***economic activity***
- ***New businesses*** created



- Long term ***gas supply*** opportunity for Alaskans
- A more diversified economy for ***decades***

AGIA can help deliver a successful gas pipeline if we....

Use Objectives instead of Prescriptive Requirements

- Prescribing <u>solutions</u> will not result in the best project
  - A better project will result from allowing the market to respond to the State's objectives

- Subsidization is contrary to FERC regulation

  "It is consistent with our guiding principle...to adopt rolled-in rate treatment up to the point that would cause there to be a subsidy of expansion shippers by initial shippers, if any subsidy were to be found." [FERC Order 2005, para. 125]

- Agree that evaluation should be done in an open and transparent way

AGIA can help deliver a successful gas pipeline if we....

Avoid Exclusivity to Ensure a Pipeline Gets Built

- AGIA may preclude a successful project from moving forward
  - expedited regulatory handling offered only to licensed project
  - State can be penalized for assisting other project
  - AGIA may conflict with Federal law and regulation

- Should the State pick an exclusive winner based only on a proposal?

- The market will determine the best solution through actual performance

- Alaska Natural Gas Pipeline Act is a good model
  - Provides expedited regulatory handling to <u>any</u> project

AGIA can help deliver a successful gas pipeline if we....

Address Resource Terms to Allow a Project to Proceed

- The resource terms in AGIA will not encourage the firm transportation commitments needed for a successful project
- Solving resource issues with clarity will enable a successful open season which is the key to advancing the project
- BP wants to develop mutually agreeable resource terms

What is so important about FT?

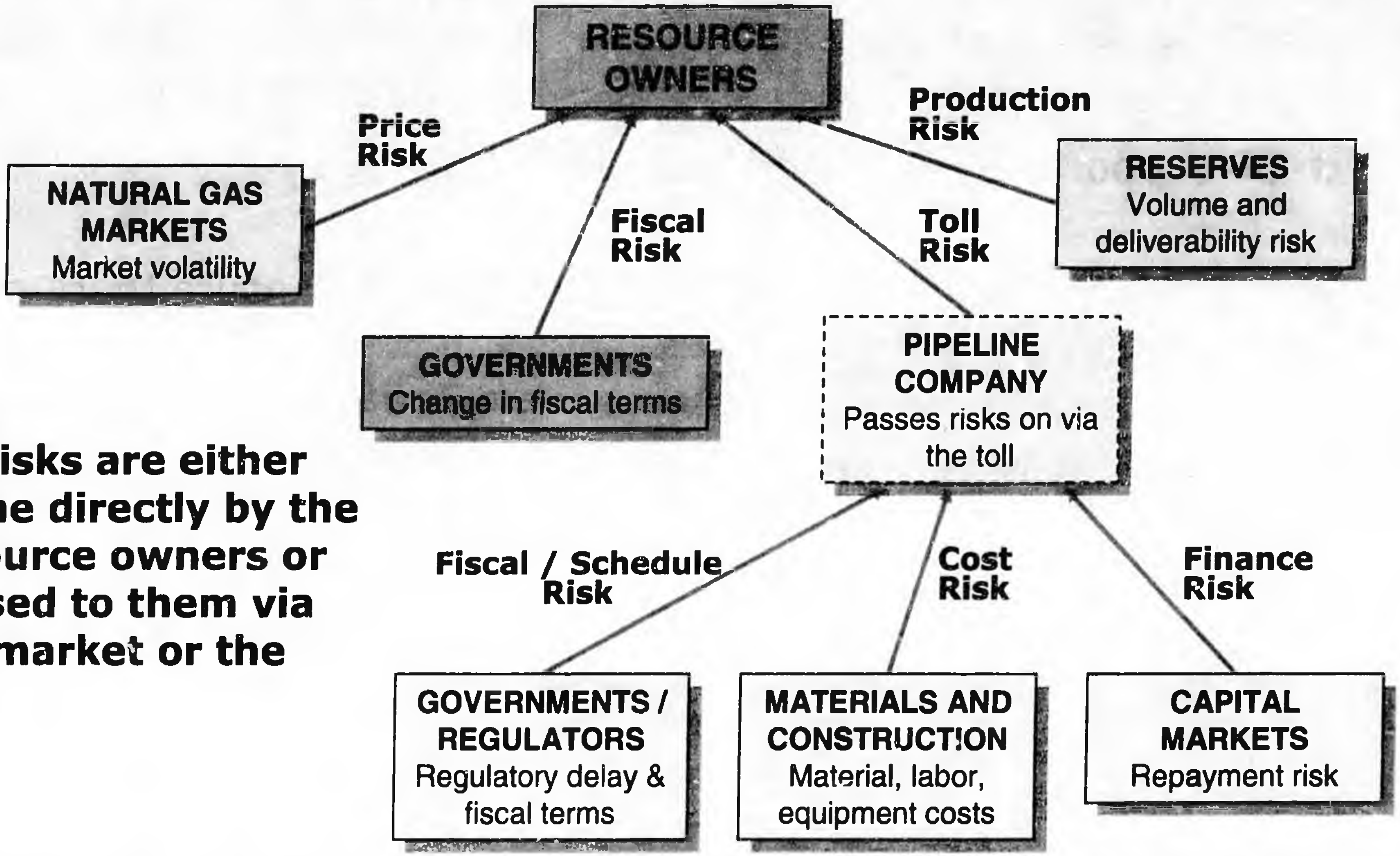
- Firm Transportation commitments (FT) by the resource owners are needed for a gas pipeline company to get financing
  - "No customers, no credit, no pipeline" (TransCanada)
  - "No producers, no pipeline" (Enbridge)

- FT is a binding <u>financial</u> obligation
  - not simply "committing gas to a pipeline"

- Requires multi-billion dollar commitments by resource owners
  - Assuming 4.5 bcfd, $3.50/mcf, 25 year term......**<u>$144 billion</u>**

- Long term commitments represent <u>real risk</u>
  - Risk is borne by resource owners

Project Risk Resides with the Resource Owners



All risks are either borne directly by the resource owners or passed to them via the market or the toll.

➡ **Those bearing a risk are commercially motivated to manage that risk**

Summary

- BP wants and needs a gas pipeline
- BP supports an open and transparent process
- Key midstream issues must be addressed to ensure there are no unintended consequences
  - Encourage best solution by offering objectives, rather than requirements
  - Don't require initial shippers to subsidize others
  - Allow actual performance to determine the "winner"
- Upstream framework is critical for successful open season
  - Resource terms must be clearly defined

Alaska Gasline
PORT AUTHORITY

House Resources Committee

April 13, 2007

AGIA is Good for Alaska

Alaska Gasline Port Authority

- **Alaska Gasline Inducement Act (AGIA) Process**
  - Open, transparent and competitive
  - Identifies clear evaluation criteria
  - Inducements to project applicants in exchange for specific commitments
  - Empowers selected applicant to build successful consortium, leading to open season

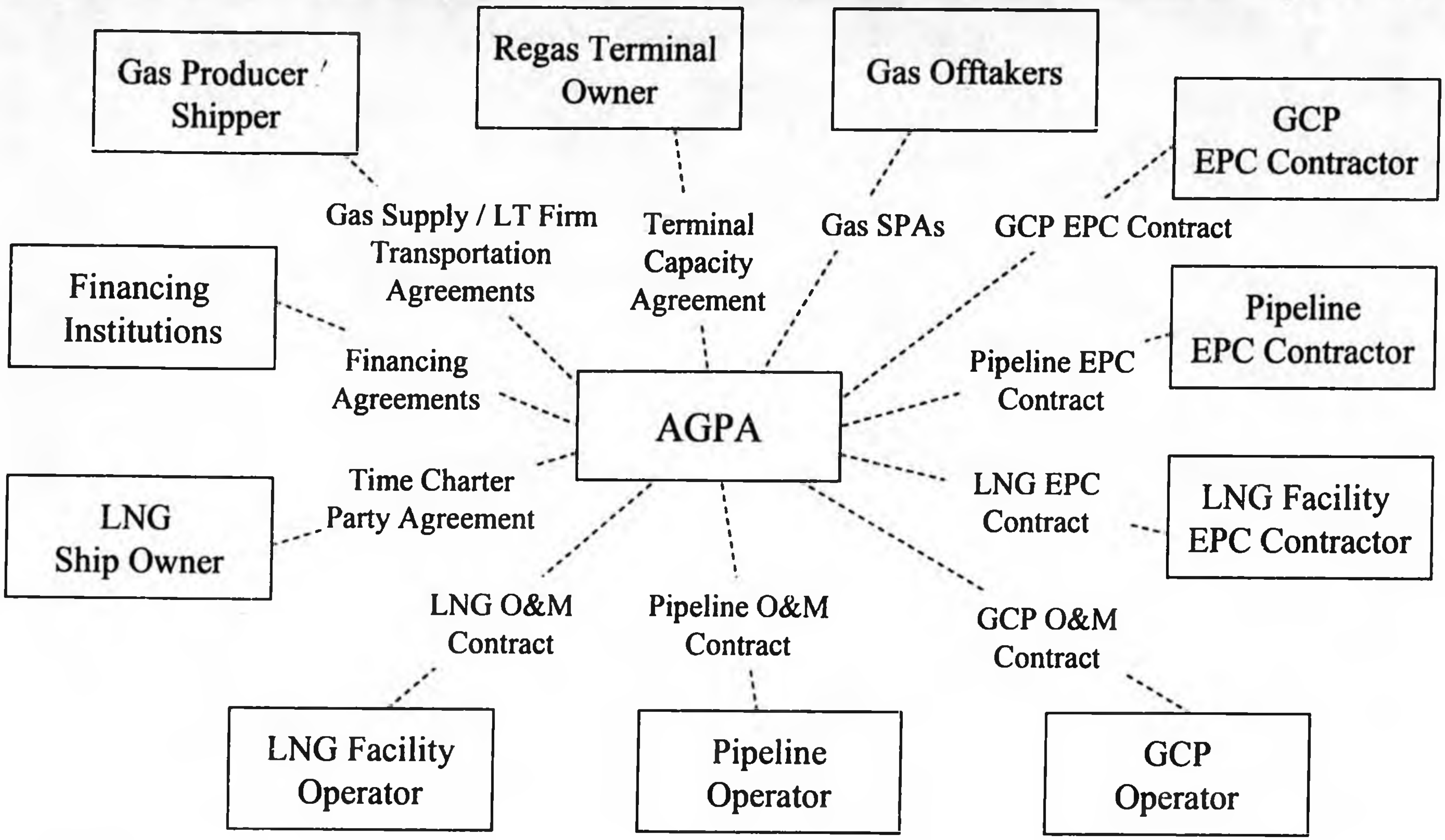
- **Return to Stranded Development Gas Act Process?**
  - No identified criteria
  - No requirement to justify need for 30-45 years of concessions in excess of $10 billion
  - State in compromised negotiating position
  - No project commitments other than spending levels – due diligence only criteria
  - Oil tax concessions beginning now for 30 years with no commitment to build a line

The Alaska Gasline Port Authority ("AGPA")

Formed to ensure:

1. A gasline is built
2. Stable source of energy to Alaskans not tied to Lower 48 price index (Henry Hub, etc.)
3. All pipeline and liquefaction associated jobs are within the state of Alaska; including construction, operation, and maintenance
4. Direct net-project revenue sharing – 60% to State – 30% to every Alaska municipality – 10% in energy related benefits to rural Alaska
5. Earliest opportunity for in-state gas availability
6. Greatest opportunity to supply gas liquids to in-state markets
7. Market optionality for Alaska's gas

Indicative AGPA Project Structure



- Industry leaders will be involved in all components of AGPA's project

AGPA Project Description

Gas Conditioning Plant in Prudhoe Bay

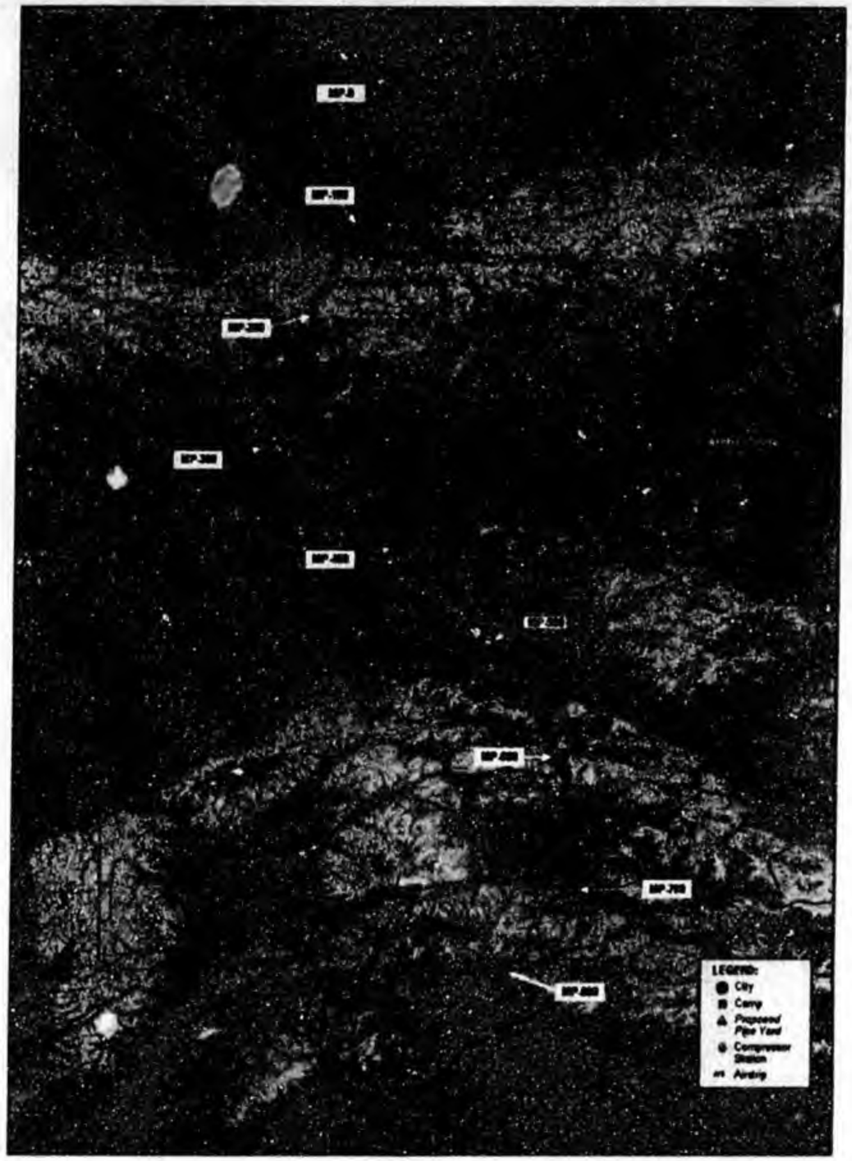
- removes impurities
- compresses and chills the gas to pipeline specifications

Pipeline from Prudhoe Bay to Valdez

- parallel to TAPS
- pre-build to Delta Junction for later tie-in for the Alaska/Canada Highway Project
- tie-in at Glennallen for a spur line to Alaska South Central natural gas grid

LNG Facility in Valdez

- integrated LNG liquefaction and LPG extraction facilities
- includes storage and vessel loading facilities



Project Status

1. Project Route Permitted

2. The 12 Senior Permits Acquired
   - Yukon Pacific Corporation
   - $100 million expended
   - Right-of-way
   - Project FEIS
   - LNG terminal permit

3. Bechtel Cost Estimates
   - Complete & Updated

4. Marine Transportation / Jones Act
   - MOU with the largest LNG shipping company in the world – Mitsui OSK Lines

5. Access to Multiple Markets
   - Only West Coast receiving terminal under construction
   - West Coast Alternatives
   - Hawaii
   - Pacific Rim

6. Anticipated Financing
   - 80% debt (Federal loan guarantee available)
   - 20% private funding

Financing Approach

- Limited recourse project financing
  - well-established financing approach for capital-intensive energy or infrastructure projects around the world
  - Project is sole source of repayment of loans – limited or no recourse to sponsors and other Project participants

- The key factors for financeability
  - commercial and contractual structure
  - project economics; ability to generate cash flows sufficient to repay the debt
  - experience and track record of the various project participants, including: engineering and construction contractors, facility operators, offtakers, suppliers, etc.
  - appropriate risk allocation under project and financing agreements
  - credit worthiness of the counterparties under Project agreements

Risk Mitigation

Alaska Gasline Port Authority

- 800 mile pipeline is 100% adjacent to TAPS, 100% in Alaska

- Infrastructure in place for entire line – roads, bridges, camp pads, etc.

- LNG project: lower overall cost overrun risk:
  - liquefaction facilities utilize proven technology and well-tested design, resulting in a relatively low level of uncertainty in cost estimate
  - low level of cost uncertainty for LNG marine transportation and regasification
  - pipeline component has the highest capital cost uncertainty – for LNG project the pipeline is only a portion of overall cost to market

- LNG Project with 2/3 less cost = 2/3 less risk

Alaska's Risk

Alaska Gasline PORT AUTHORITY

- Alaska loses U.S. markets to LNG projects from elsewhere

- Expiration of $18 billion Federal Loan Guarantee

- Increased cost of construction (steel, etc.) as years of study and negotiation goes by

LNG Project is Economic

Alaska Gasline Port Authority

- Robust economics with a forecast of internal rate of return in excess of <u>30%</u> to upstream producers with no tax concession by State

- Greatest benefits to the State of Alaska

- Favorable economics takes into consideration AlCan Highway pre-build to Delta Junction

- Win-Win for Alaska for LNG:
  - Capture West Coast market now **<u>plus</u>** enable a later AlCan Highway project to proceed when ready

Advantages of LNG from Alaska

Alaska Gasline PORT AUTHORITY

- The Alaska LNG project will benefit from an efficient, low-cost liquefaction operation:
  - ambient conditions (low average temperatures) in Valdez result in significant unit cost savings in comparison with liquefaction facilities located in tropical climate
  - efficiency gains estimated in the range of 30 – 40%

- Most other LNG projects have significantly higher marine transportation costs to market due to longer shipping distances

- Many other LNG projects involve higher upstream costs due to complex, expensive field development
  - Alaska benefits from substantial existing North Slope infrastructure and developed fields (Prudhoe Bay)

Advantage of LNG for Alaska – Right Sized Project

- Gas requirements:
  - Current ANS discovered gas resource: 35 Tcf
  - Alaska LNG project initial phase gas requirements: 15-25 Tcf (1.5-2.5 bcf/d)

- Maximum current offtake allowed for PBU is 2.7 bcf/d (AOGCC Rule 9)
  - LNG: approximately 2 bcf/d offtake

- The Alaska LNG project will enable Alaska's gas to reach market sooner, while exploration efforts are underway for the larger pipeline projects

- AGPA provides Alaska's vast gas resources the significant benefit of market optionality

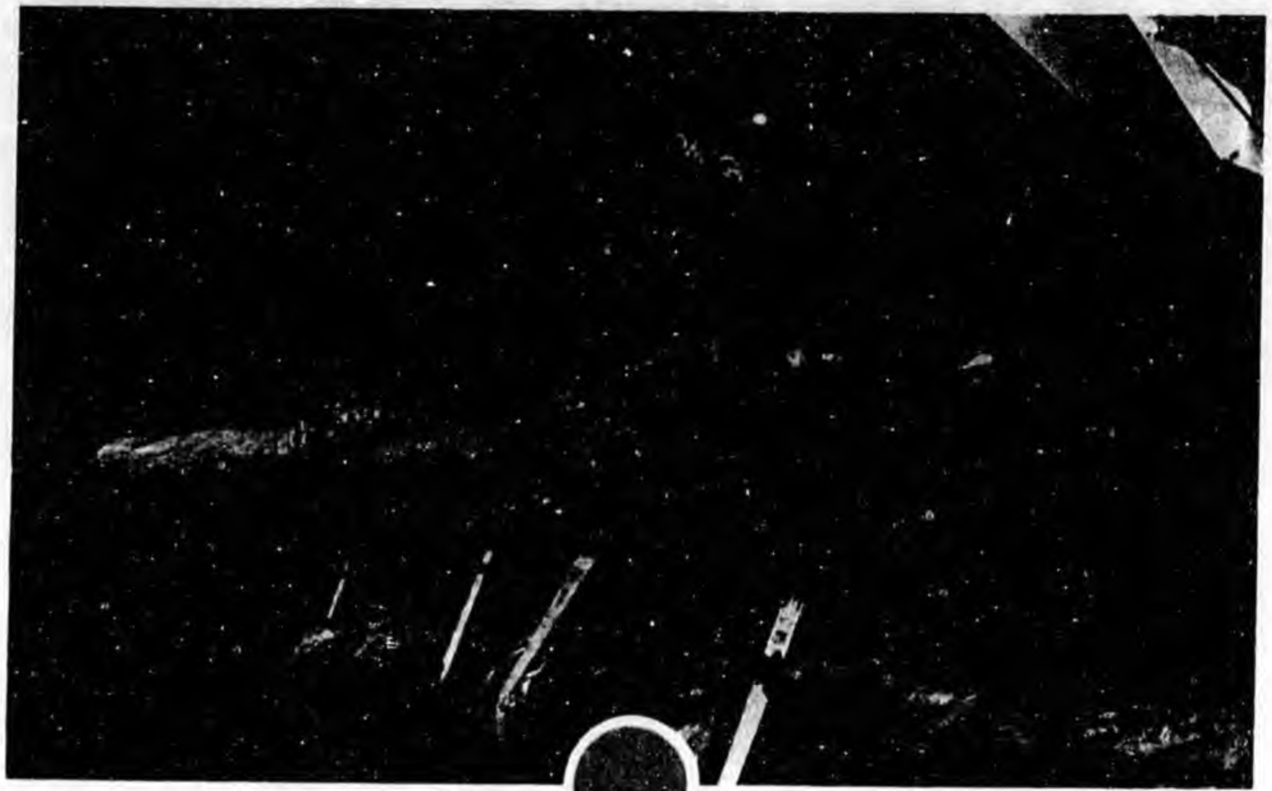
AGIA Suggested Amendments

Alaska Gasline Port Authority

- More detail required from Canadian line applicants
- If offtake amounts exceed AOGCC Rule 9 limitations (2.7 bcf/d less field use), must have already filed an application with AOGCC for increased offtake limits
- Additional gas reserves needed? Budget and timeline for exploration program
- Analysis of anticipated oil loss from PBU if volume exceeds AOGCC Rule 9 limitations
- Analysis of liquids availability in Alaska for value added processing
- Timeline for project start up and completion for present value analysis
- Current project cost estimate required with application

AGIA benefits towards advancing gas pipeline

- Rolled in rates – good for Alaska's future
- Allows for independently owned infrastructure
- Follows successful model used in other countries who also use rolled in rates and independently owned pipelines.
- $500 million skin in the game – sends very positive message about Alaska's desire to commercialize Alaska's gas



Testimony of Kirk Morgan,
President, Kern River Gas Transmission Company
State of Alaska
House Resources Committee
April 13, 2007

I appreciate the opportunity to submit written testimony to this committee on behalf of MidAmerican Energy Holdings Company concerning the proposed Alaska Gasline Inducement Act.

My name is Kirk Morgan. I am president of Kern River Gas Transmission Company, a wholly owned subsidiary of MidAmerican Energy Holdings Company. MidAmerican has assets totaling $37 billion and an employee base of 18,000. MidAmerican, through Kern River and its sister company, Northern Natural Gas, owns and operates more than 17,500 miles of interstate natural gas transmission pipelines with a combined capacity exceeding 6.4 Bcf/d. MidAmerican's pipelines deliver approximately 8.3% of the natural gas delivered in the United States. The Kern River pipeline, which our company built in 1991, brings natural gas from the Rocky Mountain supply basins across 926 miles of rugged mountainous and remote desert terrain to customers in Utah, Nevada and California. Kern River was the largest gas pipeline project to have been built in the United States in more than a decade. In 2003, Kern River expanded the pipeline, more than doubling its capacity, adding 717 miles of 36-inch and 42-inch diameter pipeline. The $1.2 billion project was completed on time, $87 million under budget, and helped restore stability to energy markets in the Western United States.

MidAmerican is a subsidiary of Berkshire Hathaway, Inc. Berkshire is one of only a few companies in the world with a AAA credit rating. Berkshire has a market capitalization in excess of $160 billion. It is recognized world-wide for financial strength, investment acumen and integrity.

The development of Alaska's huge natural gas reserves is essential to both Alaska and the United States. Projected market growth, combined with a decline in North American production, has created a growing supply/demand imbalance that cannot be adequately addressed by traditional gas supply basins alone. Alaska's natural gas is needed to help ensure energy security, reliability and price stability in the United States.

The Alaska natural gas pipeline project is unprecedented in its scale and complexity. The successful development of the project will require an alignment of stakeholder interests, including the state of Alaska, the North Slope producers, future North Slope explorers and producers, a pipeline developer, shippers and the federal government.

Projects of this scale can be easily delayed. (That has been the history of this project.) Only through proper planning, organization and execution can the project achieve its goals to accelerate development of Alaska's natural gas resources and transport gas to lower 48 markets at the lowest reasonable cost. To do otherwise will relegate this project and development of this resource to reacting to the next energy crisis where goals are frequently compromised in the interest of expediency.

MidAmerican has a serious interest in developing this project in a manner that is consistent with the state of Alaska's interests. From our perspective, the negotiations conducted by the previous administration under the Stranded Gas Act were not fruitful for many reasons. Foremost among these were that they produced proposals not supported by the people of the state; they failed to give serious consideration to alternative proposals for development; and they consumed years without advancing the project.

We believe AGIA is a positive step toward revitalizing the gas pipeline development process in a way that will move the project forward. The bill will allow consideration of competing proposals and ideas for developing the pipeline. The state benefits from such competition. The bill offers positive inducements to those who already have discovered gas to commit to the pipeline, while defining tariff provisions that will encourage new exploration. And the bill offers inducements to a pipeline developer to advance the project in a manner that the state defines as in its best interest. Perhaps most importantly, the bill establishes a process where each party that proposes to develop the line must make meaningful commitments to development milestones for the legislature and the public to see what it will and will not do and by what dates.

AGIA is a good first step. AGIA is an open, transparent and competitive process designed to advance the project on a deliberate schedule and in a manner that achieves the overarching goals of the State which are to 1) encourage new exploration on the North Slope, 2) provide for expansion of the pipeline as new reserves are brought into production, 3) achieve the lowest cost commercially reasonable tariff, 4) create jobs for Alaskans, and 5) provide natural gas to Alaskans for in-state use.

AGIA recognizes the magnitude of front-end development risks and offers to share that risk, in a significant way, by offering dollar-for-dollar matching of initial development expenditures, by offering worker training for Alaskans, and by committing to expedite state permitting requirements. These, plus separate inducements offered to resource owners, are significant commitments which signal to the marketplace that the project is moving on a serious and credible path to completion. In the absence of such progress, markets will have no alternative than to seek other means to meet market demand. The most significant alternative would be to allow imported LNG even greater market access, uncontested by development of Alaska's natural gas resources.

While LNG is certainly a necessary part of the natural gas resource mix, it makes little policy sense to unnecessarily increase our reliance on foreign energy from many unstable and unpredictable regions around the world. This project, in MidAmerican's view, is undeniably necessary and the time is now to push it forward. The key to moving the project forward is to determine the appropriate balance of risks and rewards for all stakeholders.

There is an alternate approach. The North Slope producers have for years articulated their "must haves" before advancing the project. You have heard these prerequisites before including: 1) tax and royalty certainty on gas and on oil, 2) regulatory certainty in both the U.S. and Canada, 3) cost reductions through technological advancements, and 4) federal enabling legislation.

This approach is effectively saying that the project will get started if and when all of the pre-conditions have been met and all concessions have been extracted. This approach has proven to be ineffective in advancing the project.

MidAmerican's approach is different. We believe the project can be advanced concurrent with resolution of issues that today remain outstanding. I want to emphasize MidAmerican's view that alignment of stakeholder interests is essential. Parties will understandably act in their self-interest and in their own business interest. That is why stakeholder interest alignment is critical to a successful project. That alignment must clearly set forth the roles and responsibilities of each party, as well as the commercial structure which will balance the risks and rewards, such that investment expectations will be known up front. Our approach does not exclude interested parties or discount new ideas which may be offered to help manage project risks. We know that even if the pipeline is developed by an independent developer, the North Slope producers will play the crucial role as shippers on the line and sellers of gas to other shippers. MidAmerican, as an independent pipeline, is impartial and in a unique position to help facilitate solutions when stakeholders' interests diverge. We are confident that an appropriate capital structure and rate design, coupled with our low cost of capital and project experience, can result in a project structure with appropriate allocations of risk and reward for all stakeholders, including the state of Alaska and the producers.

Indeed, MidAmerican believes that an independent pipeline provides the best alignment of interests. National energy policy promotes, in fact requires, competition and the unbundling of market segments. For example, the market structure in the United States typically requires that exploration and production, interstate transportation, marketing and distribution be performed by separate companies. Competition, not market concentration, will lead to efficient markets. MidAmerican has no upstream, downstream or global commercial interest that would create any conflicts of interest or raise any type of market power concern with respect to this project. Accordingly, MidAmerican's interests align extremely well with the state of Alaska and include:

1) Accelerating development of this critically important project;
2) Achieving the lowest cost commercially reasonable tariff;
3) Offering a commercial structure that encourages new exploration and production to both expand and extend the life of the pipeline. Thirty-five Tcf implies only a 22-year project life, and new discoveries are critical to fill the pipeline over its useful life;
4) Providing open-access, non-discriminatory transportation services to ensure both receipts and deliveries are provided for in-state use; and
5) Ensuring Alaskan jobs and workforce development. The state's commitment to workforce training and development is extremely important. Skilled labor shortage is one of the contributing factors in construction cost increases throughout the industry. A skilled Alaskan workforce will not only ensure jobs for Alaskans, but will help address an industry-wide demand for these workers.

The process set forth in AGIA will allow these ideas, and all parties' ideas and proposals, to be advanced and tested in an open and transparent manner. We support that process and while we can understand debate over what constitutes the best pipeline development proposal, it is harder to understand why parties would object to a process that calls for an open and transparent comparison of proposals. We urge the legislature to approve this legislation this session, so that a pipeline developer can be selected in a time frame that will allow a productive 2008 field season for engineering and environmental programs to be conducted.

That concludes my prepared testimony. Thank you for the opportunity to appear before you today. I would be happy to address any questions.

Debra Higgins

From: Heath Hilyard

Sent: Friday, April 13, 2007 8:16 AM

To: Adam Berg; Crystal Novotney; Daniel Consenstein; Debra Higgins; Graham Siebe; Heath Hilyard; Jackie Schulz; Jeremy Thompson; John Davies; Julie Koehler; Louie Flora; Nancy McMullen; Peg Warren; Rep. Bob Roses; Rep. Bryce Edgmon; Rep. Carl Gatto; Rep. Craig Johnson; Rep. David Guttenberg; Rep. Paul Seaton; Rep. Peggy Wilson; Rep. Scott Kawasaki; Rep. Vic Kohring

Subject: FW: AGIA Schedule - House Resources

Attachments: Testimony of Kirk Morgan House Resources Committee.doc

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From: Morgan, Kirk T (Kern River) [mailto:Kirk.Morgan@kernrivergas.com]
Sent: Friday, April 13, 2007 8:15 AM
To: Heath Hilyard
Subject: RE: AGIA Schedule - House Resources

Heath, attached is my written testimony on behalf of MidAmerican Energy Holdings Company regarding the Alaska Gasline Inducement Act. Please contact me at 801-937-6244 if you have any questions. Thank you. Kirk

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From: Heath Hilyard [mailto:Heath_Hilyard@legis.state.ak.us]
Sent: Tuesday, April 10, 2007 5:28 PM
To: Morgan, Kirk T (Kern River)
Subject: AGIA Schedule - House Resources

Kirk-

You can also submit your written comments to this address.

Heath E. Hilyard, Committee Aide
House Resources Committee